

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION



SECURITIES EXCHANGE ACT OF 1934
Release No. 67793

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3415

ADMINISTRATIVE PROCEEDING
File No. 3-15012

In the Matter of

Scott W. Hatfield, CPA; and
S. W. Hatfield, CPA

Respondents.

DIVISION OF ENFORCEMENT'S REPLY
BRIEF IN SUPPORT OF MOTION FOR
SUMMARY DISPOSITION

The Division of Enforcement ("Division") of the United States Securities and Exchange Commission ("Commission") files this brief replying to Respondents' Response in Opposition to the Division's Motion for Summary Disposition ("Reply Brief"), and respectfully shows the following:

I.
INTRODUCTION

Respondents answer "yes" to the two key factual questions the Division must prove in this case. Those questions are (1) whether S.W. Hatfield, CPA's ("SWH") firm CPA license was expired between January 31, 2010 and May 19, 2011; and (2) whether SWH and Scott W. Hatfield, CPA ("Hatfield") issued audit reports for public company issuers while SWH's license was expired. Because Respondents admit these key points, no further analysis is required and the Court should find that Respondents violated Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act") and Rule 10b-5 thereunder and should order them to cease and desist

from further such violations and should permanently bar them from appearing before the Commission under Rule of Practice 102(e)(1)(i) and (iii).

Respondents argue, however, that the Court should not find them liable for violating Section 10(b) and Rule 10b-5 because (1) they are not “makers” of material misstatements under the United States Supreme Court’s decision in *Janus Capital Groups, Inc. v. First Derivatives Traders*; (2) their misstatements were immaterial; and (3) they lacked the scienter required by these provisions. To further their cause, Respondents misstate numerous facts to this Court in an effort to confuse the issues and shift the blame for their own misconduct to the Public Company Accounting Oversight Board (“PCAOB”) and the Texas State Board of Public Accountancy (“TSBPA”).

Finally, if the Court agrees with the Division and holds that Respondents violated Section 10(b) and Rule 10b-5 thereunder, Respondents make various rote arguments for lesser penalties and disgorgement than the Division seeks.

II.

SUPPLEMENTAL EVIDENCE SUPPORTING SUMMARY DISPOSITION

In addition to the evidence submitted in support of its underlying motion for summary disposition, the Division respectfully submits the following supplemental evidence:

Exhibit 4: Supplemental Declaration of William Treacy

Exhibit 5: Division’s Objections to the Declaration of John Koepke

III.

ARGUMENT AND AUTHORITY

A. RESPONDENTS MISSTATE NUMEROUS FACTS, BUT CANNOT OVERCOME THE EVIDENCE AND LAW AGAINST THEM.

1. Respondents Misrepresent Numerous Facts Throughout Their Response.

Having admitted the key facts warranting summary disposition in favor of the Division, Respondents attempt to confuse the Court by misstating other facts surrounding the expiration of SWH's CPA license.

a. Respondents incorrectly claim that SWH's CPA license was under "administrative suspension" or was "administratively revoked" between January 31, 2010 and May 19, 2011.

The parties agree that SWH has been licensed by the TSBPA since 1994, except for the period in which it lacked a license between January 31, 2010 and May 19, 2011. But Respondents incorrectly claim that SWH's CPA license was "administratively suspended" or "administratively revoked," by the TSBPA, and that such suspension was merely "technical" in nature. SWH's license was never revoked or suspended. *See* Supplemental Declaration of William Treacy, attached hereto as Exhibit 4 and incorporated herein ("Treacy Supp. Dec."), at ¶¶ 4-5. Rather, Respondents allowed SWH's firm license to expire on January 31, 2010, due to their own failure to complete the peer review required by the laws of the State of Texas. *Id.* at ¶ 4; *see also* TEX. ADMIN. CODE Chapter 527; TEX. ADMIN. CODE RULE § 515.3(b)(4) ("If a firm is subject to peer review, then a firm's office license shall not be renewed unless the office has met the peer review requirements as defined in Chapter 527 of this title (relating to Peer Review)). Hence, the expiration was in no way a mere administrative technicality, but the direct result of Respondents' knowing breach of the legal requirements governing the licensing of Texas CPA firms. *Id.* As a matter of law, without a current firm license as of January 31, 2010, SWH was not legally permitted to perform attest services in Texas pursuant to TEX. OCC. CODE §§ 901.351; 901.456. *Id.*

b. Respondents wrongly assert that they were exempt from PCAOB peer review.

Respondents repeatedly – and wrongly – argue that they were “exempt” from PCAOB peer review requirements. This argument directly contradicts Respondents’ Answer to the Second Corrected OIP issued in this proceeding on November 15, 2012, wherein they “admit the allegations contained in paragraph 3 of the OIP,” which itself alleges that

“[E]ach firm licensed by the TSBPA that performs attest services must enroll and participate in a peer review program. A firm that performs attest services only for issuer clients can meet this requirement through the PCAOB inspection process. On the other hand, a firm that performs attest services for any non-issuer clients must also enroll in a peer review program for review of its non-public company attest work.”

See November 15, 2012 Second Corrected OIP; Respondents’ December 20, 2012 Answer to the Second Corrected OIP;

Notwithstanding their unexplained about-face, Respondents premise their argument on their own unsupported claim that they provide attest services solely for public companies. Respondents claim that the TSBPA and PCAOB determined that SWH did not provide attest services to non-public companies. *Id.* at ¶ 8.

Respondents allege that because they did not provide attest services to non-public companies, SWH was exempt from enrolling and participating in a peer review program. *Id.* at ¶ 10. To the contrary, because SWH performed attest services for its public company clients, it was not exempt from enrolling and participating in a peer review. *Id.*; Under TEX. ADMIN. CODE Rule §527.4, each firm licensed or registered with the TSBPA that performs any attest services including audits, reviews, compilations, forecasts, projections, or special reports, is required to enroll and participate in a peer review program. *Id.*

Pursuant to TEX. ADMIN. CODE § Rule 527.1(a) the TSBPA established a peer review program to monitor CPAs' compliance with applicable accounting, auditing and other attestation standards adopted by generally recognized standard-setting bodies. *Id.* at ¶ 11. The program includes education, remediation, disciplinary sanctions or other corrective action where reporting does not comply with professional or regulatory standards. *Id.*

TSBPA-registered CPA firms who audit public companies can satisfy their statutorily required peer review for such work by participation in the PCAOB's review program. *Id.* at ¶ 12. TSBPA-registered CPA firms who also audit non-public companies can satisfy their statutorily required peer review work through a program offered by the American Institute of CPAs ("AICPA"). *Id.*

Based solely on SWH's representations that it did not perform any non-public company attestation services, the TSBPA concluded that SWH was not required to enroll and participate in a peer review program *in addition to* the PCAOB inspection program. *Id.* at ¶ 13. In other words, SWH was able to satisfy its state-mandated peer review requirement through participation in the PCAOB review program without doing more, which SWH in fact did.¹ *Id.*

Notwithstanding Respondents' repeated claims that they were exempt from peer review requirements, their own witness John Koepke unequivocally admits that "they did not have a final peer review report from the PCAOB, which was a requirement of the State Board license renewal process." (Koepke Dec at ¶ 15) (emphasis added).

¹ Notably, a firm may claim an exemption from the State of Texas's peer review requirement by filing with the TSPBA, on an annual basis, an affidavit for Exemption from Peer Review. *See* Koepke Supp. Dec. at ¶ 17. SWH did not file this affidavit for the 2010 or 2011 licensee years or otherwise assert that it was exempt from the TSBPA's mandatory peer review program. *Id.*

c. Respondents falsely claim that SWH's license expired due to no fault of their own.

Respondents falsely claim that SWH's license expired through no fault of their own. However, under TEX. ADMIN. CODE Rule §527.4, it is the responsibility of every CPA firm to anticipate its needs for peer review services in sufficient time to enable the peer reviewer to complete the peer review by the due date. Thus, every TSBPA-licensed CPA firm, including SWH, is responsible for completing peer review and, to the extent a peer review is not completed, responsibility for failure or inability to complete peer review rests with the firm. *See* Treacy Supp. Dec., at ¶ 15. The TSBPA's Licensing Division will not renew a firm's CPA license if the firm has not completed peer review. *Id.*

Respondents attempt to lay blame for their failure to timely renew SWH's license on the PCAOB's alleged "delinquency" in completing its review of SWH. But they offer no evidence that the PCAOB's review was somehow uniquely or remarkably longer than could be expected. *Id.* at ¶ 16. Furthermore, the law is clear that a firm's license will not be renewed unless and until it satisfies peer review requirements. TEX. ADMIN. CODE RULE § 515.3(b)(4) ("If a firm is subject to peer review, then a firm's office license shall not be renewed unless the office has met the peer review requirements as defined in Chapter 527 of this title (relating to Peer Review)). Hence, the duration of a review, even assuming one that is unreasonably protracted, has no bearing on a firm's obligation to timely complete the review in order to renew its CPA license. *Id.*

d. Respondents claim they did not receive any notice of the TSBPA's revocation at the time it occurred.

Respondents completely ignore undisputed evidence when they claim they received no notice that SWH's firm license expired. As detailed in the January 28, 2012 Declaration of

William Treacy, Respondents were *repeatedly* notified by statute and in writing from the TSBPA that SWH's license would expire and had in fact expired. *See* Exhibit 3, Declaration of William Treacy, at ¶¶ 5-12. In fact, the TSBPA sent written notification to Respondents notifying them of the pending expiration no later than January 1, 2010, and again numerous times thereafter. *Id.* Whether the TSPBA did or did not actually notify Respondents on the actual date SHW allowed its license to expire is immaterial.

2. Respondents Do Not Overcome The Standard For Granting Summary Disposition For The Division.

The parties agree that Rule of Practice 250(a) authorizes the Court to grant summary disposition in favor the Division if there is no genuine issue of material fact in dispute after assessing the facts and evidence and the reasonable inferences to be drawn therefrom.

Because Respondents have admitted the key facts, summary disposition in favor of the Division is warranted. In addition, Respondents have not produced evidence raising any real fact issue or calling into question any of the Division's allegations.

Respondents cite *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 249 (1986) for the proposition that, in determining the Division's motion for summary disposition, this Court should not weigh the evidence but only determine if there is a "genuine issue for resolution at a hearing." Response at p. 5. Notably, however, the *Anderson* Court went on to state that "there is no issue for [hearing] unless there is sufficient evidence favoring the non-moving party for a jury to return a verdict for that party. If the evidence is merely colorable, or is not significantly probative, summary judgment may be granted." *Id.* at 249 (internal citations omitted).

Respondents' limited evidence is not significantly probative of any genuine issue of material fact. Importantly, neither Hatfield nor SWH submitted a declaration or other evidence to respond to the Division's motion. And the sole piece of new evidence supporting

Respondents' Response, the Declaration of Respondents' prior counsel John Koepke, is in large part inadmissibly speculative and conclusory. *See* Exhibit 5, Division's Objections to the Declaration of John Koepke. Notwithstanding its evidentiary deficiencies, Koepke's Declaration does nothing to contradict or question the Division's material factual allegations. Consequently, Respondents cannot overcome Rule 250's standard for granting summary disposition for the Division.

B. THE SUMMARY DISPOSITION EVIDENCE ESTABLISHES THAT RESPONDENTS VIOLATED SECTION 10(B) OF THE EXCHANGE ACT AND RULE 10B-5 THEREUNDER AND SHOULD BE ORDERED TO CEASE AND DESIST FROM COMMITTING OR CAUSING FUTURE VIOLATIONS OF THESE PROVISIONS.

1. Respondents Are "Makers" of Materially Misleading Statements Under the Supreme Court's Reasoning in *Janus*.

Defendants rely upon the Supreme Court's 2011 decision in *Janus Capital Groups, Inc. v. First Derivatives Traders* to broadly assert that Respondents cannot be liable under Section 10(b) of the Exchange Act and Rule 10b-5 thereunder because they are not "makers" of, or lacked ultimate authority over, the fraudulent statements contained in the 38 audit reports Hatfield caused SWH to issue while SWH's license was expired. 131 S. Ct. 2296 (2011). Rule 10b-5(b) provides that it is unlawful for any person "[t]o make any untrue statement of a material fact" in connection with the purchase or sale of a security.

Janus involved a private civil action alleging claims under Section 10(b) and Rule 10b-5(b) based on misstatements in prospectus materials issued by Janus Investment Fund. *Janus*, 131 S. Ct. at 2302. The plaintiffs alleged that Janus Capital Management, the fund's investment adviser and administrator, violated Rule 10b-5(b) because it had been significantly involved in the creation of the allegedly misleading statements. *Id.* The plaintiffs alleged that the adviser had a close relationship with the fund, exercised significant influence over the fund and its

prospectus disclosures, and was understood by investors to be the “maker” of disclosures issued by the fund. *Id.* Ultimately, the Court held that for purposes of Rule 10b-5(b), “the maker of a statement is the person or entity with ultimate authority over the statement, including its content and whether and how to communicate it.” *Id.* at 2302.

Importantly, the *Janus* Court emphasized the importance of “attribution” in identifying the maker of a statement. *Id.* The Court explained that “in the ordinary case, attribution within a statement or implicit from surrounding circumstances is *strong evidence that a statement was made by – and only by – the party to whom it is attributed.*” *Id.* (emphasis added). This is precisely the issue in this case – Respondents drafted, dated, printed on SWH letterhead, and signed audit reports for 21 issuer clients, which reports were included in papers the issuers filed with the Commission. These audit reports were indisputably attributed to Respondents.

Hence, unlike the speechwriter who is not ultimately responsible for the speechmaker’s statements, Respondents’ own words and work product form a substantial portion of the issuers’ filings, and are necessarily attributed directly to them. *See, e.g.*, Exhibit F to the Declaration of David King (“King Dec”) submitted as Exhibit 2 in support of the Division’s Motion. It is beyond dispute that Respondents had “ultimate authority” over their own audit reports, which they consented to have included in each issuer’s Commission filings. Consequently, Respondents can, and should, be held liable for violating Section 10(b) of the Exchange Act and Rule 10b-5 thereunder as the Division has alleged.²

² In addition to *Janus*, *see also See Louisiana Mun. Police Emp. Ret. Sys. v. KPMG, LLP*, 2012 WL 3903335, at *5 (N.D. Ohio Aug. 31, 2012) (corporate officer is maker under *Janus* of statement attributed to him in company press release); *SEC v. Daifotis*, 2012 WL 2132389, at *5 (N.D. Cal. June 12, 2012) (defendant was maker under *Janus* of statements that were specifically attributed to him in company advertisement); *In re Allstate Life Ins. Co. Litig.*, 2012 WL 1900560, at *4-5 (D. Ariz. May 24, 2012) (defendants were makers under *Janus* of statements that were attributed to them in Official Statements for municipal offerings); *City of St. Clair Shores Gen. Emp. Retirement System v. Lender Processing Serv., Inc.*, 2012 WL 1080953, at *3 (M.D. Fla. Mar. 30, 2012) (defendant corporate officers were makers under *Janus* of statements that were attributed to them in company press releases and news articles); *Lopes v. Viera*, 2012 WL 691665, at *6 (E.D. Cal. Mar. 2, 2012) (defendant organizer of company was

2. Respondents' Misstatements Were Material.

Respondents ignore the numerous cases, discussed in the Division's motion, holding that inclusion in a public filing of an audit report issued by a person not recognized as an accountant is a material misstatement. See Division's Motion at pp. 12-14 discussing *In the Matter of Ronald Effren, et al.*, 1996 SEC LEXIS 69 (January 16, 1996) (accountant willfully violated Section 17(a) of the Securities Act of 1933 ("Securities Act") and Section 10(b) when he audited an issuer's financial statements and consented to inclusion of his audit report in the issuer's public filings while he was unlicensed); *In the Matter of Alan S. Goldstein*, 1994 SEC LEXIS 2787 (SEC 1994) (accountant violated Section 17(a) of the Securities Act when he served as auditor for two registered broker-dealers while his CPA license was expired due to non-payment of required fees); *SEC v. CoElco, Ltd., et al.*, Civil Action No. 86-7892 (C.D. Cal.) (October 25, 1988); 1988 SEC LEXIS 2184 (October 31, 1988) (permanent injunction entered against accountant for violating and aiding and abetting violations of the antifraud provisions based on his issuance of audit reports, while unlicensed, that were included in an issuer's Commission filings); *SEC v. Texas Gulf Sulphur Co.*, 401 F.2d 833, 860-62 (2d Cir. 1968) (a person violates Section 10(b) and Rule 10b-5 by making material misstatements in, or omitting material information from, a periodic report or other filing with the Commission); see also, e.g., *SEC v. Todd*, 642 F.3d 1207, 1221 (9th Cir. 2011) ("[I]nformation regarding a company's financial condition is material to investment"); *United States v. Reyes*, 2009 U.S. App. LEXIS 18426 (9th Cir. 2009) ("We have recognized that HN2information regarding a company's

maker under *Janus* of financial information in offering document where document stated the financial information had been provided to the company by him); *In re Textron, Inc.*, 2011 WL 4079085, at *6 (D.R.I. Sept. 13, 2011) (defendant CEO of company was maker under *Janus* of statements that were attributed to him in company press releases); *In re Merck & Co., Inc. Sec., Derivative & ERISA Litig.*, 2011 WL 3444199, at *25 (D.N.J. Aug. 8, 2011) (defendant EVP of company was maker under *Janus* of statements that were attributed to him in news articles and company press releases);

financial condition is material to investment.”); *SEC v. Murphy*, 626 F.2d 633, 653 (9th Cir. 1980) (“[S]urely the materiality of information relating to financial condition, solvency and profitability is not subject to serious challenge.”).

Rather than confront the weight of the case law squarely against them on the issue of materiality, Respondents argue that materiality is a fact issue the Division cannot prove in summary disposition, citing *Fecht v. Price Co.*, 70 F.3d 1078, 1081-82 (9th Cir. 1995) (wherein the court was not considering materiality in the context of deciding a motion for summary judgment, but instead reversed the district court’s dismissal of plaintiff shareholders’ 10(b) action against defendant). In *Fecht*, however, the court clearly stated that a materiality analysis

“requires delicate assessments of the inferences a reasonable shareholder would draw from a given set of facts and the significance of those inferences to him, and these assessments are peculiarly ones for the trier of fact. Similarly, whether a public statement is misleading, or whether adverse facts were adequately disclosed is a mixed question to be decided by the trier of fact. Therefore, only if the adequacy of the disclosure or the materiality of the statement is so obvious that reasonable minds could not differ are these issues appropriately resolved as a matter of law.”

Id., at 1080. Hence, where the statements and omissions at issue are so obviously inadequate or misleading that reasonable minds could not differ as to their import, summary dispositions is appropriate. In this case, Respondents’ audit reports represented to their client-issuers’ shareholders and potential investors that the issuers’ financial statements were accurate and fair and conformed to generally accepted accounting principles – the very type of financial information that courts have routinely found to be material. *SEC v. Todd*, 642 F.3d 1207, 1221 (9th Cir. 2011) (“[I]nformation regarding a company’s financial condition is material to investment”); *United States v. Reyes*, 2009 U.S. App. LEXIS 18426 (9th Cir. 2009) (“We have recognized that information regarding a company’s financial condition is material to

investment.”); *SEC v. Murphy*, 626 F.2d at 653 (“[S]urely the materiality of information relating to financial condition, solvency and profitability is not subject to serious challenge.”). The only reasonable inference to be drawn from these facts is that investors would consider Respondents’ lack of a CPA license and their willingness to knowingly issue audit reports despite having no license important factors in deciding whether to rely on the audit reports, the issuers’ financial statements they endorse, the financial condition of the issuers’ businesses, or whether even to invest with an issuer.

Respondents contend that the “best and most probative evidence of materiality would be what an investor actually said regarding the importance of” Respondents’ misrepresentations and omissions, but they offer no such evidence in their favor. Response, at pp. 8-9. Of equal importance, Respondents distort and misstate the facts in an effort to manufacture a “disputed fact issue precluding summary disposition.” Response, at p. 9. For example, Respondents

- (a) incorrectly and without credible evidence point to the “remarkable delay by the PCAOB in completing its work,” as the driving force behind the TSBPA’s “administrative and retroactive revocation” of SWH’s license;
- (b) falsely represent that Respondents were unable to renew SWH’s license due to the pendency of the PCAOB’s peer review and not because of any misconduct by them;
- (c) mistakenly claim that they were not subject to PCAOB peer review requirements and that the PCAOB concluded that SWH did not perform work for non-issuer clients; and
- (d) wrongly assert that SWH’s license renewal was “delayed” because of the PCAOB’s review.

As discussed in Section III(A)(1) above, Respondents mischaracterize and misrepresent the plain and clear facts to the Court in a last ditch effort to confuse the issues and avoid summary disposition.

3. Respondents' Conduct Exhibited a High Degree of Scienter.

Respondents repeatedly attempt to shift the blame for their actions to the PCAOB and the TSBPA, including when arguing that they lacked the requisite intent to deceive required for liability under Section 10(b) and Rule 10b-5.

Notably, at no point in these proceedings have Respondents claimed that they did not know SWH's firm license was expired between January 31, 2010 and May 19, 2011. Nor do Respondents argue that they were unaware they were not permitted to issue audit reports for public company clients without a firm license. In fact, Respondents admit that they knew they could not renew SWH's license because they had not obtained final peer review report from the PCAOB. *See* Koepke Declaration at ¶ 15.

The fact of the matter is that whether PCAOB delayed completing its review to Respondents' detriment is irrelevant. Ultimately, Respondents do not dispute that they knew they were unable to renew SWH's license without a peer review report, knew they lacked such a report, and knowingly and intentionally proceeded to issue audit reports for 21 public companies for more than a year and half without disclosing their lack of license.

Respondents compare themselves to the defendant in *Sundstrand Corp. v. Sun Chem. Corp.*, 553 F.2d 1033, 1045 (7th Cir. 1977), who was found not to have been reckless when he "genuinely forgot" to disclose information. Response, at p. 12. Notably, however, Respondents do not claim they forgot SWH's was unlicensed or that they were prohibited from issuing audit

reports without a firm license. In fact, Respondents themselves claim *nothing* contrary to what the Division alleges, as they have not bothered to submit declarations in these proceedings.

The Division agrees with Respondents' that the Court must "look at an actor's actual state of mind at the time of the relevant conduct." *Alvin W. Gebhart, Jr. and Donna T. Gebhart*, SEC Admin. Proc. File No. 3-11953 (Nov. 14 2008). Here, there is no doubt that Respondents' actual state of mind at the relevant time involved actual awareness that SWH had no CPA license and a decision to ignore the laws of the State of Texas and issue audit reports without a license.

4. A More-Than-Sufficient Number of Respondents' Misstatements Were Made in Connection With the Purchase and Sale of Securities.

The parties agree that of the 38 audit reports Respondents prepared for 21 issuers while SWH's firm license was expired, six such issuers actually traded or issued securities during the relevant period. Thus, the "in connection with" requirement of Section 10(b) and Rule 10b-5 is met because Respondents' fraud "somehow touche[d] upon" and had "some nexus" with "*any* securities transaction." *SEC v. Clark*, 915 F.2d 439, 449 (9th Cir. 1990) (emphasis added).

In *SEC v. Zandford*, 535 U.S. 813, 819-820 (U.S. 2002), the Supreme Court stated that "we have explained that the statute should be "construed 'not technically and restrictively, but flexibly to effectuate its remedial purposes.'" (citing *Affiliated Ute Citizens v. United States*, 406 U.S. 128, 151 (1972) (quoting *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 195 (1963))). And where the fraud alleged involves public dissemination in a document such as a registration statement, Form 10-K or other such document on which an investor would presumably rely, the "in connection with" requirement is met by proof of the means of dissemination and the materiality of the misrepresentation or omission. *See In re Ames Dep't Stores Inc. Stock Litig.*, 991 F.2d 953, 963, 965 (2d Cir. 1993).

Hence, in this proceeding the “in connection with” standard is met because Respondents have been proven to be the makers of materially misleading statements and omissions disseminated publicly in Commission-filed registration statements, among other documents. Indeed, neither the Commission nor the Supreme Court has ever held that there must be a misrepresentation about the value of a particular security in order to run afoul of the Act. *Zandford*, 535 U.S. at 820.³ Hence, Respondents’ misstatements and omissions made “in connection with” six public companies’ issuance and sale of securities more than satisfy the broad statutory standard imposed by Section 10(b) and Rule 10b-5.

For all of these reasons, as well as those stated in the Division’s underlying motion, the Division asks the Court to grant its motion and hold that Respondents violated Exchange Act Section 10(b) and Rule 10b-5 thereunder and order that they cease and desist from committing or causing future violations of these provisions.

C. RESPONDENTS’ CONDUCT WARRANTS PERMANENTLY BARRING THEM FROM APPEARING BEFORE THE COMMISSION AND REQUIRING THEM TO PAY DISGORGEMENT, PREJUDGMENT INTEREST, AND SECOND TIER CIVIL PENALTIES.

1. A Permanent 102(e) Bar is Appropriate in This Case.

Rule of Practice 102(e) is the primary tool available to the Commission to preserve the integrity of its processes and ensure the competence of the professionals who appear and practice before it. *In the Matter of Michael C. Pattison, CPA*, 2012 SEC LEXIS 2973, 15-16

³ The “in connection with” standard in Commission actions is as broad and flexible as is necessary to accomplish the statute’s purpose of protecting investors. *See SEC v. Hasho*, 784 F. Supp. 1059, 1106 (S.D.N.Y. 1992) (“any statement that is reasonably calculated to influence the average investor satisfies the ‘in connection with’ requirement of Rule 10b-5.”); *SEC v. Benson*, 657 F. Supp. 1122, 1131 (S.D.N.Y. 1987) (misstatements in annual and quarterly reports satisfy connection requirement because an investor would rely on such documents in deciding whether to purchase securities); *SEC v. Warner*, 652 F. Supp. 647, 651 (S.D. Fla. 1987) (allegation that fraud affected market for publicly traded security established “in connection with” element sufficient to withstand motion to dismiss); *SEC v. Joseph Schlitz Brewing Co.*, 452 F. Supp. 824, 829 (E.D. Wis. 1978) (material omissions from press releases and SEC filings satisfied connection requirement because reasonable investor might rely thereon and information is calculated to influence investors); *SEC v. Gen. Refractories Co.*, 400 F. Supp. 1248, 1257 (D.D.C. 1975) (material omissions from annual reports, proxy statements and 13 D Schedules satisfied connection requirement because investors might have based investment decisions upon documents).

(SEC 2012) (*citing Marrie v. SEC*, 374 F.3d 1196, 1200 (D.C. Cir. 2004)). Respondents lack the requisite qualifications to represent other issuers before the Commission for all of the reasons stated by the Division, specifically, their knowing and repeated violations of Section 10(b) and Rule 10b-5 by issuing audit reports while SWH's license was expired and consenting to the inclusion of the reports in issuers' Commission-filings. *See In the Matter of Robert W. Armstrong III*, Exchange Act Rel. No. 51920 at fn. 69 ("This reading of the Rule also conforms with past settled cases in which we have suspended accountants under Rule 102(e)(1)(iii) who either were not licensed or who had allowed their licenses to lapse at the time of their misconduct.") (emphasis added); *see also In the Matter of Gerald M. Kudler*, Admin. File No. 3-8896 (Dec. 18, 1995) (barring, under Rule 102(e)(3), a respondent who never held a CPA license for preparing false and misleading annual and quarterly reports); *In the Matter of Stumacher*, Admin. File No. 3-9432 (Sept. 24, 1997) (barring, under subparagraphs (i) and (iii) of Rule 102(e)(1), a respondent who never held a CPA license for, among other things, falsely holding himself out as a CPA when signing audit reports); *U.S. v. Arthur Young & Co.*, 465 U.S. 805, 817-18 (1984) (accountant who disregards professional obligations lacks competence to discharge "'public watchdog' function"' demanding "total independence from the client at all times").

Notwithstanding their unsuitability to practice before the Commission, Respondents are currently licensed CPAs who continue to provide attest services. They therefore pose a continuing threat to the Commission's processes and to the investing public. *See Matter of James Thomas McCurdy, CPA*, Exchange Act Rel. No. 49182, 82 SEC Docket 282, 2004 WL 210606 * 9 (Feb. 4, 2004) ("McCurdy is an actively licensed CPA, and we anticipate that he will continue to conduct audits of public companies."); *In re Marrie*, Securities Act Rel. No. 1823,

Exchange Act Rel. No. 48246, 80 SEC Docket 2163, 2003 WL 21741785 * 19 & n.51 (July 29, 2003) (accountants who are “actively licensed CPAs create a significant risk that they may return to that profession and again conduct audits of public companies”).

In an effort to mitigate against a permanent debarment, Respondents incorrectly claim that SWH’s license was merely “administratively suspended” through no fault of their own, and characterize their misconduct as an “isolated negligent violation,” while at the same time they admit knowingly issuing 38 separate audit reports, each without a valid firm license, during a nineteen month period. But SWH’s license was not merely administratively suspended. *See* Section III(A)(1) above; Response at p. 15.

In addition, Respondents claim without proof that a permanent debarment is unnecessary because Hatfield is “in all likelihood nearing the end of his professional accounting career.” *Id.* at p. 16. This argument is, at best, a double-edged sword. If indeed Hatfield is nearing the end of his accounting career, a permanent debarment will not impact him as meaningfully as if he were just starting out. Regardless, the Court’s determination of appropriate sanctions to impose against Respondents should be driven by the nature of their conduct, not their unsworn and unproved claims of hardship or pleas for leniency.

Finally, Respondents contend that because SWH has been licensed since 1994 *but for* the nineteen month expiration, their conduct is somehow less egregious than cases in which auditors who were never licensed were barred under 102(e). To the contrary, the undisputed evidence in this proceeding is that Respondents acted with extreme egregiousness, as they admit they knew they could not renew their license without a final peer review report from the PCAOB but nevertheless ignored the law and provided attest services for multiple issuers for more than a year and a half.

For all of these reasons, the Court should conclude that Respondents willfully violated Exchange Act Section 10(b) and Rule 10b-5 thereunder and also lack the requisite qualifications to represent others and should, therefore, be permanently barred from appearing before the Commission under Rule of Practice 102(e)(1)(i) and (iii).

2. Respondents' should be required to pay disgorgement, prejudgment interest and second tier civil penalties.

a. Joint and several disgorgement and prejudgment interest.

Respondents do not dispute that they charged and received \$187,222 in fees for the audit reports they prepared while SWH was unlicensed. Nor do they challenge the Division's conclusion that they are obligated to pay \$9,743.84 in prejudgment interest on their disgorgement sum. These funds are directly traceable to Respondents' fraud and, consequently, Respondents should be ordered to disgorge them, jointly and severally, and pay the legal interest thereon.

Because the Division has proved the essential elements of its claims and provided this Court with a reasonable approximation of the proper amount for disgorgement, Respondents' must clearly demonstrate that \$187,222 is not a reasonable approximation of the Respondents' ill-gotten gains. *See SEC v. Lorin*, 76 F.3d 458, 462 (2d Cir. 1996); *SEC v. Patel*, 61 F.3d 137, 140 (2d Cir. 1995). Respondents do not challenge the Division's disgorgement calculation, but instead argue that disgorgement is unnecessary to deter Respondents from committing future violations of the securities laws. Response at p. 17. Given Respondents' degree of willfulness in this case, disgorgement of the funds they obtained from their wrongful conduct is a reasonable method for deterring future misconduct, which deterrence is necessary considering Respondents' continued practice as CPAs. *See e.g., In the Matter of Halt, Buzas & Powell, Ltd.*, Exchange Act Rel. No. 57179 (Jan. 22, 2008) (auditor who issued reports on public company financial

statements while not registered with the PCAOB ordered to disgorge fees from those engagements).

b. Second tier civil penalties.

Respondents fail to create any genuine issue of material fact regarding whether Respondents should be penalized for their knowing and intentional disregard of the laws prohibiting Texas CPAs from providing attest services without a license. Respondents admit they were unable to renew SWH's license because its peer review was incomplete. They also acknowledge issuing 38 audit reports over the nineteen months that SWH was unlicensed without ever disclosing the fact that it was operating in violation of the law. Further, Respondents admit that they continue to practice as CPAs, which creates the possibility for them to once again disregard the rules and regulations governing CPAs.

There are no facts that weigh against imposing second tier civil penalties against Respondents. *See* Sections 21B(c) of the Exchange Act, *New Allied Dev. Corp.*, Exchange Act Release No. 37990 (Nov. 26, 1996), 52 S.E.C. 1119, 1130 n.33; *First Sec. Transfer Sys., Inc.*, 52 S.E.C. 392, 395-96 (1995); *see also Jay Houston Meadows*, Exchange Act Release No. 37156 (May 1, 1996), 52 S.E.C. at 787-88, *aff'd*, 119 F.3d 1219 (5th Cir. 1997); *Consol. Inv. Servs., Inc.*, 52 S.E.C. 582, 590-91 (1996). Respondents' conduct was not an isolated event but a series of willful violations spanning more than a year and a half. And while Respondents admitted their conduct, they have never acknowledged their wrongdoing. Nor have Respondents cooperated with the Division in these proceedings; instead they failed to appear for subpoenaed testimony in the underlying investigation and failed even to appear through a Declaration in this proceeding. Finally, Respondents have never disclosed their financial condition to the Division so there is no evidence that they are unable to pay penalties.


IV.
CONCLUSION

For the foregoing reasons and those stated in its underlying motion and the incorporated evidence, the Division respectfully requests that its motion for summary disposition be granted, and that an order issue

- (a) requiring Scott W. Hatfield and S.W. Hatfield, CPA to cease and desist from violating or causing violations of Section 10(b) of the Exchange Act of 1934 and Rule 10b-5 thereunder;
- (b) requiring Respondents to pay \$187,222 in disgorgement, jointly and severally;
- (c) requiring Respondents to pay \$9,743.84 in prejudgment interest, jointly and severally;
- (d) requiring Scott W. Hatfield to pay a civil penalty of no more than \$75,000 per violation, in an amount to be determined by the Court;
- (e) requiring S.W. Hatfield CPA to pay a civil penalty of nor more than \$375,000 per violation, in an amount to be determined by the Court; and
- (f) permanently barring Respondents from appearing or practicing before the Commission pursuant to Rule of Practice 102(e)(1)(i) and 102(e)(1)(iii).

Dated: March 11, 2013.

Respectfully submitted,



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UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934

Release No. 67793

ACCOUNTING AND AUDITING ENFORCEMENT

Release No. 3415

ADMINISTRATIVE PROCEEDING

File No. 3-15012

In the Matter of Scott W. Hatfield, CPA; and S. W. Hatfield, CPA Respondents.	
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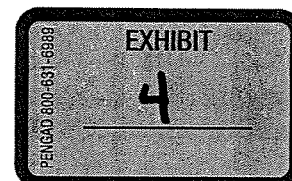
SUPPLEMENTAL DECLARATION OF WILLIAM TREACY

I, William Treacy, do hereby declare under penalty of perjury, in accordance with 28 U.S.C. § 1746, that the following is true and correct, and that I am competent to testify as to the matters stated herein:

1. I am over 21 years of age. I am employed by the Texas State Board of Public Accountancy ("TSBPA") as Executive Director, a position I have held since September 1990.

2. I make this Declaration in support of the Division of Enforcement's Reply Brief in Support of Motion for Summary Disposition in the above-captioned administrative proceeding. This Declaration is intended to supplement my January 28, 2013 Declaration in this proceeding, which Declaration and exhibits thereto and incorporated herein by reference.

3. I have reviewed the Response in Opposition to Division of Enforcement's Motion for Summary Disposition and Brief in Support and observed many instances in which Respondents S.W. Hatfield, CPA and Scott W. Hatfield, CPA ("Respondents") incorrectly stated



the requirements for renewing a CPA firm license in Texas and the facts and circumstances surrounding the expiration of SWH's firm license.

4. SWH has been licensed by the TSBPA since 1994, *except for* the period in which its license was expired between January 31, 2010 and May 19, 2011.

5. Respondents incorrectly claim that SWH's CPA license was "administratively suspended" or administratively revoked," by the TSBPA, and that such suspension was merely "technical" in nature. SWH's license was never revoked or suspended. Rather, Respondents allowed SWH's firm license to expire on January 31, 2010, due to failure to complete peer review required by the laws of the State of Texas. *See* TEX. ADMIN. CODE Chapter 527; TEX. ADMIN. CODE RULE § 515.3(b)(4) ("If a firm is subject to peer review, then a firm's office license shall not be renewed unless the office has met the peer review requirements as defined in Chapter 527 of this title (relating to Peer Review)). Hence, the expiration was in no way a mere technicality, but the result of Respondents' failure to adhere to the legal requirements governing the licensing of Texas CPA firms.

6. Without a current firm license as of January 31, 2010, SWH was not legally permitted to perform attest services in Texas pursuant to TEX. OCC. CODE §§ 901.351; 901.456.

7. Respondents claim that at all relevant times, and now, they provide attestation services solely for public companies.

8. Respondents claim that the TSBPA and PCAOB determined that SWH did not provide attest services to non-public companies. The sole basis on which TSBPA made this determination was Respondents' own statements to the TSBPA. In my experience, it is very unusual for a CPA firm to provide attest services solely to public companies.

9. I am unaware of any determination by the PCAOB that SWH performed no non-public company attest services.

10. Respondents incorrectly assert that because they did not provide attestation services to non-public companies, SWH was exempt from enrolling and participating in a peer review program. To the contrary, because SWH performed attestation services for its public

company clients, it was not exempt from enrolling and participating in a peer review program. Under TEX. ADMIN. CODE Rule §527.4, each firm licensed or registered with the TSBPA that performs any attestation services or any accounting or auditing engagements, including audits, reviews, compilations, forecasts, projections, or special reports, is required to enroll and participate in a peer review program.

11. Pursuant to TEX. ADMIN. CODE § Rule 527.1(a), the TSBPA established a peer review program to monitor CPAs' compliance with applicable accounting, auditing and other attestation standards adopted by generally recognized standard-setting bodies. The program includes education, remediation, disciplinary sanctions or other corrective action where reporting does not comply with professional or regulatory standards.

12. TSBPA-registered CPA firms who audit public companies can satisfy their statutorily required peer review for such work by participation in the PCAOB's inspection program. TSBPA-registered CPA firms who also audit non-public companies can satisfy their statutorily required peer review work through a program offered by the American Institute of CPAs ("AICPA").

13. Based solely on SWH's representations that it did not perform any nonpublic company attestation services, the TSBPA concluded that SWH was not required to enroll and participate in a peer review program *in addition to* the PCAOB inspection program. In other words, SWH was able to satisfy its state-mandated peer review requirement through participation in the PCAOB review program.

14. A firm may claim an exemption from the State of Texas's peer review requirement by filing with the TSPBA, on an annual basis, an affidavit for Exemption from Peer Review. SWH did not file this affidavit for the 2010 or 2011 licensee years or otherwise assert that it was exempt from the TSBPA's mandatory peer review program.

15. Respondents incorrectly claim that SWH's license expired through no fault of their own. Under TEX. ADMIN. CODE Rule §527.4, it is the responsibility of every CPA firm to anticipate its needs for peer review services in sufficient time to enable the peer reviewer to

complete the peer review by the due date. Thus, *every* TSBPA-licensed CPA firm, including SWH, is responsible for completing peer review and, to the extent a peer review is not completed, responsibility for failure or inability to complete peer review rests with the firm. The TSBPA's Licensing Division will not renew a firm's CPA license if the firm has not completed peer review.

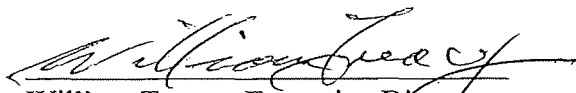
16. Respondents contend that the PCAOB was "delinquent" in completing its review of SWH and that the entire review process was "remarkably" delayed. In my experience, the issuance of the PCAOB's report on its inspection of SWH was not uniquely or remarkably delayed. The duration of a peer review, even assuming one that is unreasonably protracted, has no bearing on a firm's obligation to timely complete the peer review in order to renew its CPA license.

17. Respondents' claim that they were provided no notice that SWH's license would expire, or had expired, is not correct in light of the repeated statutory and written notifications provided them as detailed in ¶¶ 5-12.

18. Finally, when the TSBPA reissued SWH's license, it did so effective May 19, 2011. The renewal was not retroactive to January 30, 2010. The TSBPA does not issue licenses, or renew licenses, retroactively. Consequently, any audit reports Respondents issued between January 31, 2010 and May 19, 2011 were issued without a valid firm license.

I declare under penalty of perjury, in accordance with 28 U.S.C. § 1746, that the foregoing is true and correct.

Executed this 7th day of March 2013.


William Treacy, Executive Director
Texas State Board of Public Accountancy

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 67793

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3415

ADMINISTRATIVE PROCEEDING
File No. 3-15012

In the Matter of

Scott W. Hatfield, CPA; and
S. W. Hatfield, CPA

Respondents.

DIVISION OF ENFORCEMENT'S
OBJECTIONS TO THE DECLARATION OF
JOHN KOEPKE

The Division of Enforcement ("Division") of the United States Securities and Exchange Commission ("Commission") files these objections to the Declaration of John Koepke, submitted as Exhibit 1 in support of Respondents' Response in Opposition to Division of Enforcement's Motion for Summary Disposition, and respectfully shows the following:

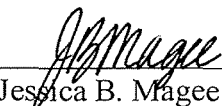
<i>PARAGRAPH</i>	<i>TESTIMONY</i>	<i>OBJECTION</i>
3	"protracted peer review"	Koepke's practice does not focus on TSBPA or PCAOB compliance issues or representation of auditors on issues of peer review or licensing requirements, thus he lacks foundation to testify about whether the peer review was "protracted" and such testimony is speculative and conclusory.



8	"extended time period"	Koepke's practice does not focus on TSBPA or PCAOB compliance issues or representation of auditors on issues of peer review or licensing requirements, thus he lacks foundation to testify about whether the peer review was "protracted" and such testimony is speculative and conclusory.
8	"These attempts, which included correspondence that I sent directly to George Diacont, Director of the PCAOB's Division of Registration and Inspection, were unsuccessful."	The referenced correspondence is unproven but for Koepke's self-serving statements that he made such correspondence and the documents themselves would be the best evidence of their existence.
9	"[T]he State Board closed its file on the Respondents on July 8, 2010 because of the failure of the PCAOB to issue a final peer review report."	The cited portions of testimony lack foundation and are inadmissibly speculative and conclusory
9	"I understand that this closure by the State Board resulted entirely from the delay by the PCAOB in issuing a final peer review report and was in no way the fault or responsibility of the Respondents."	The cited portions of testimony lack foundation and are inadmissibly speculative and conclusory

Dated: March 11, 2013.

Respectfully submitted,


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